

# FINAL BILL REPORT

## ESHB 1044

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C 370 L 05

Synopsis as Enacted

**Brief Description:** Changing pension funding methodology.

**Sponsors:** By House Committee on Appropriations (originally sponsored by Representative Sommers; by request of Office of Financial Management).

### House Committee on Appropriations

#### Background:

The Office of the State Actuary is responsible for recommending appropriate member and employer contribution rates for the Public Employees', Teachers', School Employees', and Washington State Patrol Retirement Systems to the Pension Funding Council (PFC), which adopts the rates for each fiscal biennium. Included as part of the rates recommended by the State Actuary to the PFC for the 2005-07 biennium were pre-funding for the gain-sharing benefit in the Plans 1 and 3 and contributions towards paying off the unfunded liabilities in the Plans 1.

Gain-sharing was created by the 1998 Legislature as a mechanism to increase member benefits in PERS 1, PERS 3, TRS 1, TRS 3, and SERS 3. These increases occur whenever there are extraordinary investment gains, which are defined as compound average of investment returns on pension fund assets that exceeds 10 percent over a period of four fiscal years. Once each biennium, the State Actuary determines whether gain-sharing benefits will be made. Any distributions occur in January of even-numbered years. In Plan 1, half of all extraordinary gains are used to enhance the Uniform Cost-of-Living Adjustment (Uniform COLA) that is given to eligible retirees each year. In Plan 3, half of the extraordinary gains are paid directly into eligible members' and retirees' defined contribution accounts. There have been two gain-sharing distributions since 1998, which resulted in combined benefit improvements costing roughly \$1.1 billion. When the gain-sharing benefit was created by the 1998 Legislature, language was included in the law to reserve the right of the Legislature to amend or repeal the gain-sharing benefits.

The cost of future gain-sharing has never been reflected in the basic contribution rates for the affected systems and was not included in the 2002 actuarial valuation, as the funding methodology and materiality of the gain-sharing provisions were under review. The recent 2003 Actuarial Valuation Report (prepared in December 2004) identified gain-sharing as a material liability and included this liability in calculating the basic contribution rates recommended by the State Actuary to the PFC.

While the state retirement plans that are currently open to new members (the Plans 2 and 3) are currently fully funded, unfunded accrued actuarial liabilities (UAALs) exist in both PERS 1

and TRS 1. This means that the value of the plan liabilities, in the form of members' earned benefits to date, exceed the value of the plan assets. As of the most recent actuarial valuation, the UAAL for PERS 1 is \$2.6 billion and the UAAL for TRS 1 is \$1.4 billion. The statutory funding policy for paying off the UAAL in the Plans 1 is codified as a goal within the actuarial funding chapter. Per statute, the funding process for the state retirement systems is intended to fully amortize the total Plan 1 costs by not later than June 30, 2024. The payments towards the UAAL are included in employer rates and are not shared by members. Under Chapter 11 of the Laws of 2003 (EHB 2254) the Legislature suspended the employer contributions towards the PERS 1 and TRS 1 unfunded liabilities for the duration of the 2003-05 biennium.

The State Actuary's recommended employer 2005-07 contribution rates under current law are 5.73 percent for PERS, 6.74 percent for TRS, and 7.56 percent for SERS. The recommended Plan 2 member rates for the same period are 3.38 percent for PERS 2, 2.48 percent for TRS 2, and 3.51 percent for SERS 2. Member rates in PERS 1 and TRS 1 are fixed at 6 percent. Member contributions in PERS 3, TRS 3, and SERS 3 are made into members' individual defined contribution accounts and do not affect pension system funding.

**Summary:**

Recognition of the cost of future gain-sharing benefits in retirement system contribution rates is delayed until after the 2005-2007 fiscal biennium. The Select Committee on Pension Policy will study the options available to the Legislature for addressing future gain-sharing liability, including: repealing, delaying, or suspending the gain-sharing provisions, making gain-sharing discretionary, or replacing gain-sharing with other benefits.

Contributions toward the UAAL in PERS 1 and TRS 1 are suspended for the 2005-2007 fiscal biennium. Annual contribution rates for PERS, TRS, and SERS employers and Plan 2 members are specified for each year of the 2005-2007 fiscal biennium, as part of a four-year phase-in of contribution rate increases projected for the 2005-2009 period. The employer contribution rates for FY 2006 are 2.25 percent for PERS, 2.75 percent for SERS, and 2.73 percent for TRS, and the Plan 2 member contribution rates for FY 2006 are 2.25 percent for PERS, 2.75 percent for SERS, and 2.48 percent for TRS. For FY 2007 the employer contribution rates are 3.50 percent for PERS, 3.75 percent for SERS, and 3.25 percent for TRS, and the Plan 2 member contribution rates are 3.50 percent for PERS, 3.75 percent for SERS, and 3 percent for TRS. The Pension Funding Council is required, upon completion of the 2005 Actuarial Valuation, to adopt contribution rates that complete the four-year phase-in schedule, adjusted for any material changes in benefits, assumptions, methods or experience.

**Votes on Final Passage:**

House	55	42
Senate	25	23

**Effective:** July 24, 2005

July 1, 2005 (Sections 1, 3 & 6)

July 1, 2006 (Sections 2 & 4)